



MOORS & CABOT

INVESTMENTS

Banking & Advisory Group



In Consideration of *A Plan That Works*®

A PLAN THAT WORKS ...

Introduction

We were frustrated by credit rating agencies' continued criticism that *quasi-municipal entities in Maine issue their debt with "archaic" or "weak legal provisions"*. In so doing, they contended, the issuers do not provide adequate protection to bondholders. This, despite strong financial operations and positive demographics. In our continuing effort to provide even better financings for our clients, we sought ways to address the legal and credit concerns of Moody's or Standard & Poor's. We judge that, in this way, our constituent issuers will be viewed as higher quality credits with resulting higher credit ratings. This could translate into even lower borrowing costs.

The further expectation is that an additional cost associated with "tightening up" the issue will provide net economic advantage. This is all presented with the expectation that these enhancements will be "transparent" to the issuer's operations and, in so doing, will cause no financial or additional administrative burden to the borrower.

We met with analysts at Moody's offices in New York City with a desire to address the legal and credit concerns of the rating agency and to be able to originate more secure financings for our municipal issuer clients. As a result of these meetings we developed a structure that includes an indentured pledge of net revenues, a Debt Service Reserve Fund and establishment of and conformance to certain financial covenants. This has apparently satisfied the rating agencies concern as to weak legal provisions, as well as provides a liquidity facility in the event of unforeseen temporary financial distress.

“Structure” as a Credit Enhancement

We are pleased to report the success of this endeavor in that we have been able to achieve higher quality ratings, which simultaneously translated to lower borrowing costs, for the following clients:

<u>Issuer</u>	<u>Prior Rating</u>	<u>Revised Rating</u>
Kennebunk Sewer District	Baa	A
Yarmouth Water District	Baa1	A
Freeport Sewer District	Not Rated	A
Auburn Water District	Baa	A

The bonds of the above issues represented the first “structured” revenue bonds issued by each District. These included the credit enhancement by a Net Revenue Pledge with a Debt Service Reserve Fund and certain financial covenants. In so doing, we established structures which included (i) pledges of Net Revenues (thus speaking to weak legal provisions); (ii) Debt Service Reserve Funds (thus speaking to liquidity); and (iii) financial covenants which include (a) Debt Service Coverage ratios and (b) Additional Bonds Tests (thus also speaking to the legal weakness owed by statute). Ironically, this was at no peril to the Districts in that, through its historical operating experience, these tests were already satisfied! Thus, codification of such had no financial impact on the ratepayers’ fees or charges. Furthermore, the Debt Service Reserve Fund was funded through bond proceeds (with an offsetting arbitrage earnings totally negating the interest expense). Each issue received a rating of “A”! In so doing, we were able to aggressively price and market each financing. This trend continues for subsequent financings with, for example Brunswick & Topsham Water District.

While no assurances of investment grade ratings for future issues can be given, we propose this similar structure that, in our experience, stands greatest likelihood of achieving that rating at a minimum of cost and inconvenience to a borrower. The structure involves a Master Trust Indenture (the “Master Trust”) to encompass this and all future financing of the borrower, as long as bonds under the Master Trust are outstanding; and a Series Indenture (the “Series Indenture”) as the operative vehicle for a proposed issue. This achieves maxim flexibility to the borrower. And, this flexibility provides a dynamic instrument which contemplates future financings therefore (i) allowing for growth of the borrower, while (ii) providing future economies in the financing of such growth, yet (iii) provides financial covenants which intend to be transparent to borrower rather than restrictive.

The Security

The security for an issue would include, at a minimum, the following:

- A. *Pledge of Net Revenues.*
- B. Establishment of a *Debt Service Reserve Fund* (“DSRF”) pursuant to the Internal Revenue Code of 1986, as amended (the “Code”) of an amount equal to the lesser of (a) the maximum amount of annual debt service payable in any current or future fiscal year or other appropriate 12-month period on the Bonds (“Max Annual Debt Service”); (b) 125 % of the average annual debt service payable with respect to the Bonds; or (c) 10% of the original

proceeds of the bonds (also called a *4R Fund* or “reasonably required reserve or replacement” fund). This would be required only for the proposed and future issues; not for past issues⁽¹⁾.

Greater bond-holder security is established should the difference between Max Annual Debt Service and the above (b) or (c) (if required by the Code) be funded from non-bond proceeds.

C. A *Pledge to Replenish the DSRF* in subsequent years should the DSRF experience any draws.

D. Establishment of *Financial Covenants*: to include:

(1) *Debt Service Coverage* ⁽²⁾ requirement [e.g., each year’s “Net Revenue” (as defined below) as a percentage certain (e.g., 125%) of overall maximum debt service];

(2) *Retained Earnings Requirement*; and

(3) *Additional Bonds Test* (e.g., that Debt Service Coverage must be attained with the inclusion of the new bonds before the issuance of additional bonds).

E. Declaration of all *prior debt to be on parity* with the issue. Thus, past debt is not subordinated and, we expect, will rise to the higher quality level which we envision to be achieved with this structure.

F. We would not seek a lien, perfected or otherwise, of property; nor a pledge of endowment funds as collateral security for the Issue.

Summary

We endeavor to continue to utilize all of our resources, our contacts, our experience and our expertise to be an advocate for *your financings*, should we be chosen to re resent you for your issues. A graphical presentation of this structure is presented as follows:

NOTES: ⁽¹⁾ This portion of the DSRF is typically funded with Bond proceeds and held by the indenture trustee for the benefit of the bondholders; If not otherwise used, the 4R Fund would pay all, or a portion of, the last year’s debt service. This would be required only for the proposed and future issues and not for past issues.

⁽²⁾ Debt Service Coverage Ratio:

$$\begin{array}{r} \text{Operating Income} \\ + \text{Operating Expenses} \\ \hline \text{Net Operating Income} \\ \text{Non-operating Income} \\ + \text{Depreciation} \\ \hline \text{Net Revenues Available for Debt Service} \\ \hline \text{Ratio} \\ \text{Current Debt Service} \\ \text{Net Revenues} \div \text{Current Debt Service} = \\ \text{Debt Service Coverage} \end{array}$$

